FILED
AUG 2 19
HAROLD B. WILLEY

IN THE

Supreme Court of the United States

No. 285

UNITED STATES OF AMERICA,
Respondent,

v.

E. REGENSBURG & SONS, a corporation,
Petitioner,

and

ADELE REGENSBURG, Executrix of the Estate of ISAAC REGENSBURG, deceased,
Defendant.

UNITED STATES OF AMERICA,
Respondent,

v.

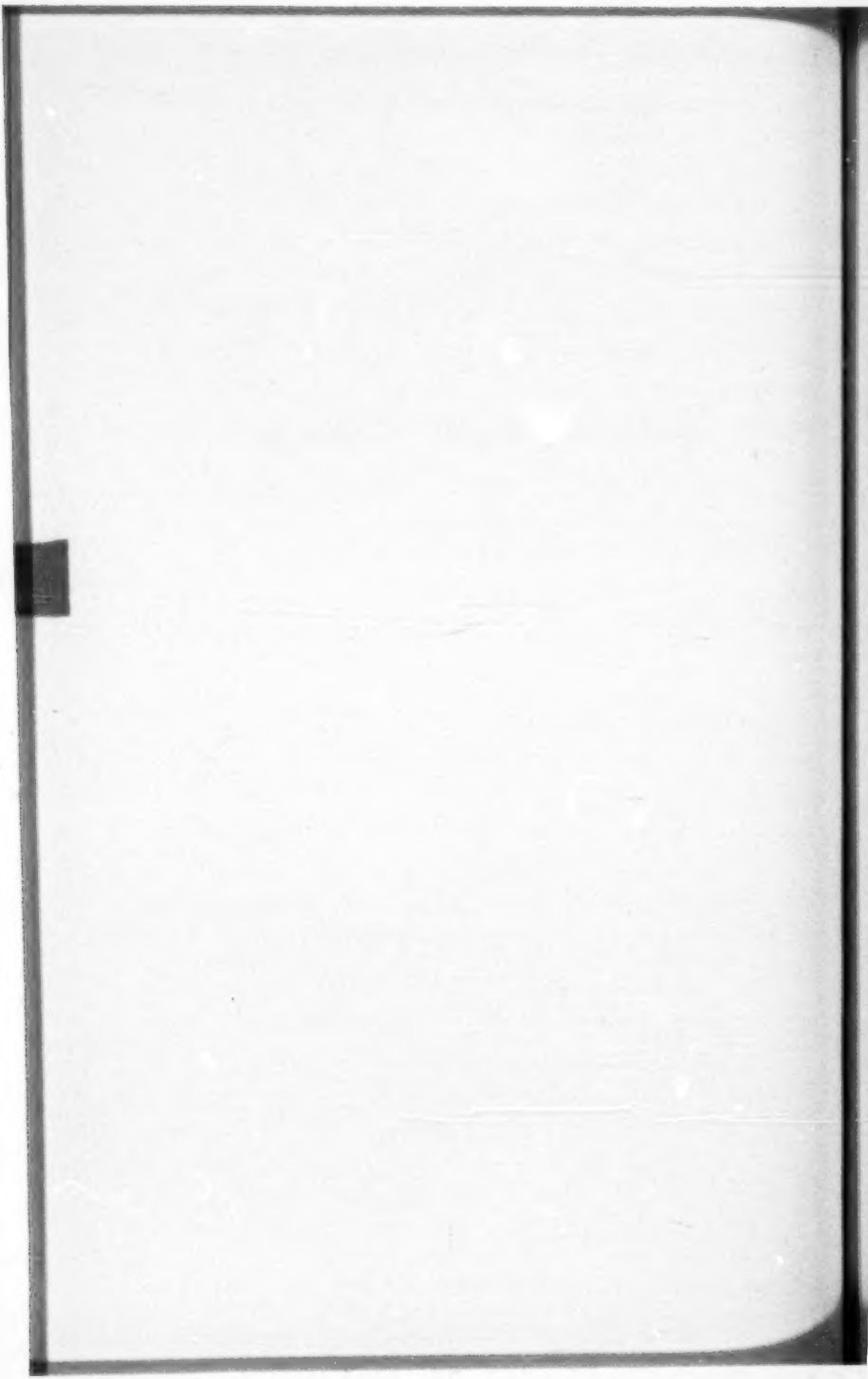
E. REGENSBURG & SONS, a corporation,
Petitioner,

and

SALLY REGENSBURG PERLS ROSS and EDWARD BELLETTE REGENSBURG, as Administrators c. t. a. of the Estate of Bellette Regensburg, deceased,
Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ARTHUR B. HYMAN,
Attorney for Petitioner,
19 Rector Street,
New York, New York.



INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement	3
Reasons for Granting the Writ	7
Conclusion	11
Appendix A—Statutes	12
B—Opinion by the Court of Appeals	14

CITATIONS

Cases:

Commissioner v. *Tower*, 327 U. S. 280 (1946)	9
Corliss v. *Bowers*, 281 U. S. 376 (1930)	9
Ellner v. *Isaacson*, 165 N. Y. Supp. 942 (App. T. 1st Dept. 1917) (not officially reported)	9
Famous Realty, Inc. v. *Frindel*, 135 N. Y. S. 2d 261 (Sp. Ct. Kings 1954) (not officially reported)	9
Fox Film Corp. v. *Loughman*, 259 N. Y. 30, 180 N. E. 885 (1932)	9
Groh's Sons v. *Groh*, 80 App. Div. 85, 80 N. Y. Supp. 438 (1903), rev'd on other gds., 177 N. Y. 8 (1903)	9
Matter of Calder v. *Graves*, 261 App. Div. 90, 24 N. Y. S. 2d 797 (3d Dept. 1941), aff'd mem. 286 N. Y. 643 (1941)	9

PAGE

Montgomery v. *Commissioner*, 6 T. C. M. Dec. 15,922 (1947) (not officially reported) 8

Regensburg v. *Commissioner*, 144 F. 2d 41 (C. A. 2d 1944) 8

Statutes:

Internal Revenue Code (1939)

Section 3670 ..... 3, 12

Section 3672 ..... 3, 9, 12

Section 3678 ..... 3, 12

IN THE

Supreme Court of the United States

No. .....

UNITED STATES OF AMERICA,
Respondent,

v.

E. REGENSBURG & SONS, a corporation,
Petitioner,

and

ADELE REGENSBURG, Executrix of the Estate of ISAAC REGENSBURG, deceased,
Defendant.

UNITED STATES OF AMERICA,
Respondent,

v.

E. REGENSBURG & SONS, a corporation,
Petitioner,

and

SALLY REGENSBURG PERLS ROSS and EDWARD BELLETTE REGENSBURG, as Administrators c. t. a. of the Estate of Bellette Regensburg, deceased,
Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

E. Regensburg & Sons prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in each of the above-entitled cases on April 11, 1955.

Citations to Opinions Below

The opinion of the District Court (R. 41-50) is reported in 124 F. Supp. 687. The opinion of the Court of Appeals, printed in Appendix B hereto, *infra*, p. 14, is reported in 221 F. 2d 336.

Jurisdiction

The judgment of the Court of Appeals in each of the above cases was entered on April 11, 1955 (R. 178-180). Rehearing was denied on May 4, 1955 (R. 188). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

Questions Presented

1. Has the Government, suing as a judgment creditor, rights superior to or different from those possessed by any other judgment creditor; or

2. More concretely, fraud being expressly disavowed, and obviously non-existent, may the previously acquired liens of another creditor, the validity of which the taxpayers during life and their estates after death, consistently acknowledged be disregarded and sales in foreclosure of such liens be set aside in order that the Government may enforce collection of its tax judgments, not from the delinquent taxpayers, but the prior lien creditor?

3. Are decisions of the Tax Court determining that moneys withdrawn by the judgment debtors, though charged to their accounts, were nevertheless taxable to them as dividends received, controlling precedent for the decision in these cases that the judgment debtors were not obligated to return such monies to the Company from whom they were withdrawn?

Statutes Involved

The statutory provisions involved are Sections 3670 3672 and 3678 of the Internal Revenue Code (1939). They are printed in Appendix A, *infra*, page 12.

Statement

In 1934, to secure the repayment of money then owing or which might thereafter become due E. Regensburg & Sons by reason of their withdrawals on open account, Isaac and Bellette Regensburg pledged with the Company their shares of its capital stock (R. 84). Eleven years thereafter, in 1945, by virtue of tax judgments based upon a determination of the Commissioner of Internal Revenue that such withdrawals for the years 1936 through 1940 were taxable dividends, the United States obtained liens upon their property (R. 88).

On February 2, 1947 and March 3, 1948, E. Regensburg & Sons, upon due notice to and without objection by the Government, and in compliance with the formalities required by the New York Lien Law, foreclosed upon and at such foreclosures bought the shares previously pledged with it by Isaac and Bellette (R. 86, 97). In 1949 the United States, asserting a lien against the shares superior to that of E. Regensburg & Sons, commenced these actions to set the foreclosure sales aside (R. 8-9, 27-28). Jurisdiction of the District Court was invoked under Section 3678 of the Internal Revenue Code (1939). Isaac's and Bellette's estates, parties to the actions, admit in their answers the existence of the indebtedness and concede the propriety of the foreclosures (R. 15, 35). Neither fraud nor collusion is claimed, and indeed are expressly disavowed by the Government (R. 62).

There has never been any dispute as to the facts. Briefly stated, they are as follows: E. Regensburg & Sons is a

corporation engaged in the business of manufacturing cigars (R. 16, 30). It was organized in 1903 as the outgrowth of a family partnership, and upon its organization Edward Regensburg and each of his sons, Isaac, Mortimer, Jerome, Melville and Bellette received stock and notes from the Company in exchange for their respective interests in the partnership (R. 80; Exhibits 3-7 through 3-12). From the very beginning open accounts were maintained by the father and five brothers, which reflected withdrawals made by them from time to time and to which the Company credited all salaries paid to them, dividends declared by the Company, payments of cash or cash equivalent and interest on Company notes, as well as other payments by the brothers to the Company (R. 81-83; Exhibits 3-7 through 3-12). Although others acquired shares in the Company as early as 1910 none made such withdrawals.

Formally declared dividends between 1905 and 1935 amounted to $2,800,000 (R. 92) of which approximately $1,800,000 was paid to the four brothers (Exhibits 3-7 through 3-11).

The dividend credits were in proportion to stockholdings, and the salary credits corresponded to the nature and importance of the officer's position in the Company (R. 89, 91; Exhibits 3-7 through 3-11). The debit entries, however, recording withdrawals, are without pattern. They are unrelated in time and amount, and correspond neither to the officer's position in the Company nor to his stockholdings. They were made individually by certain of the stockholders without concert of action (R. 58, 89, 91, Exhibits 3-7 through 3-11).

A complete record of the withdrawals was kept by the Company at all times (Exhibits 3-7 through 3-11). It carried the loans as accounts receivable on the Company's books (R. 69; Exhibits 3-18). They were treated as assets and set forth as such in its balance sheets, income tax returns and financial statements furnished credit agencies

and banks which loaned it moneys and honored its trade acceptances (R. 83). This treatment was ratified and approved by the indebted stockholders. They signed the Company's income tax returns (R. 68), and Isaac acknowledged the existence of the debts to the banks furnishing credit to the Company (R. 65). The withdrawals were recognized and acknowledged by both Company and shareholders in the minutes of the meetings of the stockholders and board of directors as valid and binding obligations (R. 130-146).

In 1928 the Company's accountant wrote Jerome Regensburg, at the request of Isaac Regensburg, setting forth the "important facts" in connection with a plan then under consideration to reorganize and to sell a portion of the stock to be issued under the plan to private bankers. He stated in that letter that under the proposed plan

> "The overdrafts of the stockholders up to December 31, 1928 will be deducted from the amount of cash each one is to receive so that none of the overdrafts will be carried over into the new organization". (R. 169-170)

Under the proposed plan the stockholders would have received $4,740,000 in cash (R. 169) and from this Isaac, Bellette and their brothers would have repaid the sum of $1,301,000 (R. 110, Exhibits 3-7 through 3-11).

On October 8, 1934 the Company, Isaac and Bellette, their brothers, and other shareholders who had never been and never were to become indebted to the Company, entered into a written agreement whereby the shareholders agreed that if any one of them sold his stock in the corporation while indebted to it, so much of the purchase price as would be necessary to discharge such debt would be paid to the Company; or if the Company were the purchaser, it would deduct the amount of the indebtedness from the purchase price, the shareholder to continue liable

for the unpaid balance. The agreement further provided, in *haec verba:*

> "Each of the stockholders hereby gives and grants to the company a lien upon his shares of stock to the extent of any indebtedness owing or which may hereafter become owing from such stockholder to the company." (R. 97)

At the time of the execution of the agreement, the certificates of stock of all the shareholders were endorsed with a legend referring to the agreement. The certificates belonging to Isaac, Bellette, and their brothers were retained by the Company as security, and the certificates of the non-indebted stockholders returned to them.

Jerome Regensburg died in 1941 indebted to the Company on open account for $251,277.01 (R. 110). Although the offer of evidence to this effect was rejected, the colloquy shows that the amount of his indebtedness was paid in 1951 (R. 78).

Isaac and Bellette Regensburg died in December 1943 and February, 1944 indebted to the Company for $1,700,610.87 and $317,719.45, respectively (R. 110). Their estates did not pay their indebtedness, and upon due notice to and without objection by the Government, their stock was sold at public auction in 1947 and 1948 in accordance with the formalities required by the New York Lien Law (R. 86). The foreclosures resulted in the compulsory forfeiture by Isaac's and Bellette's estates of interests in the Company having book values (even if all the loans be entirely excluded from realizable assets) of $260,000 and $160,000, respectively, at a time when Bellette's estate owed the Government only $40,000, and Isaac's estate owed $197,000 (R. 4, 23, Exhibit 3-18).

Reasons for Granting the Writ

1. These cases involve fundamental concepts in the administration of the Internal Revenue laws which are of paramount importance.

2. The decision of the Court of Appeals is in direct conflict with fundamental principles of law and equity which are universally accepted. It disregards the doctrine oft enunciated by this Court that the Government's rights are of equal but no greater force than those of any individual. It places the Government as a judgment creditor in a preferred position not granted by statute nor established by decisions of any court. No other judgment creditor could possibly have secured the judgments review of which is here sought.

The Government in these actions was confronted with an apparently insuperable obstacle. By reason of their withdrawals on open account the taxpayers owed large sums of money to E. Regensburg & Sons, and had pledged their stock with Company to secure the repayment of their indebtedness years before liability for the taxes involved accrued. After due notice to the Government and without objection or action by it, or claim of any right superior to that of the Company, the stock so pledged had been sold at public auction to satisfy the Company's liens.

To find for the Government in these actions to set aside those foreclosure sales, the Court below was compelled to hold that the stockholders owed the Company nothing. To achieve this result it found that the monies which the taxpayers had withdrawn represented dividends paid by the Company, that there was therefore no indebtedness, and consequently no valid pledge. It is evident that the Court believed its conclusion justified upon the ground that the withdrawals were held dividends for the purpose

of imposing tax liabilities upon the withdrawing stockholders. *Regensburg* v. *Commissioner*, 144 F. 2d 41 (C. A. 2d 1944). In its brief to the Court of Appeals the Government suggested such an approach, and the Court implicitly adopted it, disregarding the fact that these were not actions to establish tax liabilities, but judgment creditor's actions to set aside sales in foreclosure of a prior lien creditor.

The suggestion made by the Government that though the withdrawals might in fact have been loans under State law they should nevertheless be considered dividends for collection purposes because they were so considered for taxing purposes is legally untenable. Only once before, as far as we can find, has the Government suggested that monies held to be the taxpayer's for the purpose of imposing a tax are also his for the purpose of collecting the tax, and the suggestion was flatly rejected. In *Oroville Montgomery* v. *Commissioner*, 6 T. C. M. Dec. 15,922, decided August 25, 1947, although Montgomery had assigned the proceeds of a judgment to his wife, it was taxed to him as income. The Government sought to collect its tax judgment out of the monies so assigned. The Court stated:

> "The difficulties incident to a solution of the problem of petitioner's liability as a transferee of her husband's income tax stem in large part from the difference in concept of property and income under general law on the one hand, and income tax law on the other."

and thereupon refused to permit the Government to collect its tax judgment out of the proceeds of the monies assigned.

Moreover, the decision of the Court below is in irreconcilable conflict with the decisions of this Court which have long recognized that the legal significance of facts under

tax law may be quite different than their legal significance under state law. *Commissioner* v. *Tower*, 327 U. S. 280 (1946); *Corliss* v. *Bowers*, 281 U. S. 376 (1930).

The Court's departure from settled and fundamental principles focuses attention upon the flagrant inconsistency contained in the judgments which it affirmed. They do not state that the individuals were not indebted to the Company, nor that the Company had no lien upon their stock. Rather, following the complaints (R. 3, 22), they merely state that the lien of the Government for its taxes "is a valid and prior lien" and that it is "prior in preference to the claim of the defendant E. Regensburg & Sons" (R. 21, 39). There is no middle ground. Either there was no indebtedness on open account between 1903 and 1934, and hence no lien at all, or, the individuals were indebted to the Company and the Company's lien, pursuant to Section 3672 I. R. C. (1939), was superior to that of the Government.

3. The decision of the Court of Appeals is in direct conflict with the applicable New York Law.

It is well settled in New York that dividends may be declared by informal agreement among *all* stockholders [*Groh's Sons* v. *Groh*, 80 App. Div. 85 (1st Dept., 1903), rev'd on other gds. 177 N. Y. 7 (1903)], and that withdrawals, though otherwise characterized, may for purposes of taxation be considered as dividends if drawn from a company by its sole stockholder. *Fox Film Corp.* v. *Loughman*, 259 N. Y. 30 (1932); *Matter of Calder* v. *Graves*, 261 App. Div. 90, aff'd 286 N. Y. 643 (1941).

It is likewise settled, however, that absent either of these conditions, withdrawals booked and acknowledged as obligations must be repaid on corporate demand. Thus, in *Ellner* v. *Isaacson*, 165 N. Y. Supp. 942 (App. T. 1st Dept., 1917) and *Famous Realty Inc.* v. *Frindel*, 135 N. Y. S. 2d 261 (Sp. Ct., Kings 1954), cases on all fours, the

Court refused to permit a stockholder of a closely held corporation to retain monies drawn by him on open account upon the ground that there was no proof to support his claim that all stockholders had agreed that it need not be repaid.

Here there was no proof whatever that all stockholders of E. Regensburg & Sons had agreed that Isaac and Bellette need not repay the monies they had withdrawn. Indeed, it was established beyond the possibility of controversy that as between the Company and the withdrawing stockholders the monies withdrawn were loans, carried as such on the books of the Company, shown on their balance sheets, credit statements and income tax returns, and acknowledged repeatedly by the stockholders and their estates. Though the evidence was excluded the record shows that one of the withdrawing stockholders repaid his loan to the extent of more than a quarter of a million dollars, and these very actions are predicated upon the foreclosures by the Company of the liens given it under the 1934 pledge agreement.

4. The decision of the Court of Appeals sanctioning the revolutionary doctrine that in conventional litigation the claims of the Government have a divinity denied to all others is palpably wrong, and should be reviewed and reversed by this Court.

As is usual in cases where established principles of law are destroyed or disregarded the results are confiscatory and chaotic. The results of the decision below speak for themselves. Until the decision of the Court of Appeals the liabilities created by the stockholder withdrawals were corporate assets, and each of its stockholders, non-withdrawing as well as withdrawing, to the extent of his stockholdings possessed an inchoate right to such assets. The Court of Appeals, however, in order to make it possible for the Government to collect taxes has relieved the withdrawing stockholders of their obligation to the corporation to its detriment and to the detriment of its other stockholders.

For example, Isaac Regensburg invaded the funds of the corporation to the extent of $1,700,000, although his 26% stock interest at the time of foreclosure had a book value of only $1,100,000. By virtue of this decision, however, his obligation to the corporation has been discharged, his stock restored to his estate, and the equities of the other stockholders to that extent diluted.

The Court below in effect has said to Isaac and Bellette:

> "Though the corporation has collected more than $250,000. from Jerome's estate in repayment of his obligation, you do not owe the corporation anything. Though he borrowed, you did not. Though he was required to and did make repayment, you are not. What he received he was compelled to repay. What you received, you received as a dividend and need not repay."

Thus, Isaac and Bellette are to be rewarded. Not of course because they deserve it, but because the Court could find no alternative which could enable the Government to collect its taxes. Is such a consummation worth the price that has to be paid? We cannot believe that this Court, mindful of the consequence, will permit such result to stand.

CONCLUSION

Petitioner respectfully submits that this petition for a writ of certiorari to the Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

ARTHUR B. HYMAN,
Counsel for Petitioner.

August 1, 1955.

APPENDIX A

Internal Revenue Code (1939)
Section 3670. Property subject to lien

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

Section 3672. Validity against mortgagees, pledgees, purchasers, and judgment creditors

(a) INVALIDITY OF LIEN WITHOUT NOTICE.

Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Collector * * *.

Section 3678. Civil action to enforce lien on property

(a) FILING.—In any case where there has been a refusal or neglect to pay any tax, and it has become necessary to seize and sell property and rights to property, whether real or personal, to satisfy the same, whether distraint proceedings have been commenced or not, the Attorney General at the request of the Commissioner may direct a civil action to be filed, in a district court of the United States, to enforce the lien of the United States for tax upon any property and rights to property, whether real or personal, or to subject any such property and rights to property owned by the delinquent, or in which he has any right, title, or interest, to the payment of such tax.

(b) PARTIES TO PROCEEDINGS.—All persons having liens upon or claiming any interest in the property or rights to property sought to be subjected as aforesaid shall be made parties to such proceedings and be brought into court.

(c) ADJUDICATION AND DECREE.—The said court shall, at the term next after the parties have been duly notified of the proceedings, unless otherwise ordered by the court, proceed to adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property and rights to property in question, and, in all cases where a claim or interest of the United States therein is established, may decree a sale of such property and rights to property, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States.

(d) RECEIVERSHIP.—In any such proceeding, at the instance of the United States, the court may appoint a receiver to enforce the lien, or, upon certification by the Commissioner during the pendency of such proceedings that it is in the public interest may appoint a receiver with all the powers of a receiver in equity.

APPENDIX B

Before: CLARK, Chief Judge, FRANK, Circuit Judge, and GALSTON, District Judge.

Appeal from the United States District Court for the Southern District of New York, Sylvester J. Ryan, Judge.

The defendants appeal from the judgments granting plaintiff relief against the defendants in causes arising out of the tax liens asserted by the plaintiff. Affirmed.

J. Edward Lumbard, United States Attorney for the Southern District of New York (Thomas C. Burke, Assistant United States Attorney, Of Counsel) for plaintiff-appellee.

Paskus, Gordon & Hyman (Arthur B. Hyman, Charles H. Lieb and Robert R. Slaughter, Of Counsel) for defendant-appellant.

GALSTON, District Judge.

The primary question presented on these appeals is whether payments made to the stockholders of this family corporation were dividends, as the Government contends, or loans, as the appellants contend. In essence the same or similar question was presented to this court in *Regensburg* v. *Commissioner*, 144 Fed. 2d 41, cert. den'd 323 U. S. 783, and nothing that appears in the record herein warrants a different conclusion as to the nature of those payments.

The corporate defendant was engaged in the manufacture of cigars. It was a typical family business in that all of its capital stock, consisting of 1000 shares, was issued to Edward Regensburg, the founder, and his five sons. He and the sons were the sole officers and directors of the corporation.

The tax liabilities against Isaac Regensburg and Bellette Regensburg or their estate, as a result of the decision of the Commissioner of Internal Revenue in 1942, are the same tax liabilities which the plaintiff is seeking to collect in these suits. Notices of liens for such taxes were filed by the Government on January 17, 1945. At the time of Isaac's death, on December 1, 1943, the accumulated amount of his withdrawals from the company in excess of the amounts accrued to his account was $1,700,610.87. At the end of 1943 the amount of withdrawals by Bellette amounted to $317,719.45. He died on February 17, 1944. It was only after the deaths of Isaac and Bellette that the corporation made demand for the re-payment of the foregoing sums on the theory that they constituted loans. In 1947 and 1948 the corporation foreclosed its alleged liens on the shares of stock held by their respective estates, and the corporation bid in the stock of Isaac for the sum of $275,000 and that of Bellette for $110,000, and applied the purchase price in partial discharge of the alleged indebtedness of those two estates.

Section 3670 of the Internal Revenue Code provides that upon failure to pay taxes after demand a lien shall arise in favor of the United States, "upon all property and rights to property, whether real or personal, belonging to the delinquent taxpayer."

The question to determine is: What rights to the stock acquired by the corporation, formerly in the name of Isaac and Bellette Regensburg or their estates, did the corporation have on the date that the Government filed its tax liens?

As was said by Judge Swan in *Regensburg* v. *Commissioner, supra,* at least for the tax years 1936 to 1940 inclusive:

> "That withdrawals were recorded on the corporate books as debits against the taxpayers; that they were not proportionate to holdings of stock nor participated in by all the shareholders; and that the formalities of a dividend declaration were lacking is not con-

clusive against a finding that withdrawals were dividends," citing Chattanooga Savings Bank v. Brewer, 17 Fed. 2d 79, cert. den'd 274 U. S. 751, etc.

In respect to the contention made in the earlier case, and repeated here, that the payments were loans and should not be classified as dividends, it is significant that no note was ever executed to evidence any indebtedness on the part of the shareholders, and no interest was ever paid or accrued on the balances shown in their accounts.

If the sums that had been withdrawn from this family corporation by the stockholders were dividends and not loans, then the corporation could not acquire the shares of stock of Isaac and Bellette, because they were not indebted to the corporation. Nor are the defendants aided by New York State law. Such cases as *People ex rel. Fox Film Corp.* v. *Loughman,* 259 N. Y. 30; *Matter of Calder* v. *Graves,* 261 App. Div. 90, aff'd 286 N. Y. 643; and *Groh's Sons* v. *Groh,* 80 App. Div. 85, all sustain the principle of law that if the sums in question were withdrawn with the acquiescence of all the stockholders and without any insistence that they be repaid, they must be regarded, in New York law, as dividends, and not as loans. Nor is the appellant helped by *Ellner Co.* v. *Isaacson,* 165 N. Y. Supp. 942, or *Famous Realty, Inc.* v. *Frindel,* 135 N. Y. Supp. 2d 261.

The Government's liens, under Section 3672 of the Internal Revenue Code, accordingly must prevail over the underlying pledge agreement of 1934, because that agreement was not supported by a valid loan.

The evidence supports the district court's conclusion, which is on all fours with the holding in *Regensburg* v. *Commissioner, supra,* that the withdrawals were in fact of earnings. Even the payment by the estate of one brother, Jerome, of the alleged overdraft due from him goes only to the weight of the evidence. This occurred after the institution of the Government's actions, and little if any weight should be attached to that circumstance.

The judgments are affirmed.

No. 285

AUG 2 1955

HAROLD B. WILLEY, Clerk

United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

against

ADELE REGENSBURG, Executrix of the Estate of ISAAC REGENSBURG, deceased,
Defendant,

and

E. REGENSBURG & SONS, a corporation,
Defendant-Appellant.

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

against

SALLY REGENSBURG PERLS ROSS and EDWARD BELLETTE REGENSBURG, as Administrators, c.t.a. of the Estate of Bellette Regensburg, deceased,
Defendants,

and

E. REGENSBURG & SONS, a corporation,
Defendant-Appellant.

APPELLANT'S PETITION FOR REHEARING

UNITED STATES COURT OF APPEALS
FILED
APR 26 1955
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

PASKUS, GORDON & HYMAN,
Attorneys for E. Regensburg & Son,
Defendant-Appellant.

To the Honorable Judges of the United States Court of Appeals for the Second Circuit:

E. Regensburg & Sons, Appellant, respectfully petitions this Court for a rehearing of the appeal herein upon the ground that this Court overlooked or misapprehended dispositive questions of law and fact, and has failed to note the effect of its decision upon the corporation and its stockholders.

I.

The Court has misapprehended or ignored applicable principles of law, and in the process has failed to appreciate the effect of its decision upon the corporation and its stockholders.

A departure from the norm has a tendency to create chaos. This decision will, if it stands, have precisely that effect upon the affairs of E. Regensburg & Sons and its stockholders.

Until the decision of this Court the liabilities created by the stockholder withdrawals were corporate assets, and each of its stockholders, non-withdrawing as well as withdrawing, to the extent of his stockholdings possessed an inchoate right to such assets. This Court, however, in order to make it possible for the government to collect taxes has relieved the withdrawing stockholders of their obligation to the corporation to its detriment and to the detriment of its other stockholders.

For example, Isaac Regensburg invaded the funds of the corporation to the extent of $1,700,000 during a period when its net worth totalled approximately $4,000,000. His interest in the corporation, representing 26% of its capital stock, at the time his stock was sold pursuant to the 1934 pledge agreement, amounted to approximately $1,100,000. By virtue of this decision, however, his stock has been restored, and his obligation to the corporation discharged.

This Court in effect has said to Isaac and each of the withdrawing stockholders:

"You do not owe this corporation anything. You did not borrow at all. The corporation paid it to you as a dividend."

Thus, for maladministration of the corporate affairs they are to be rewarded. Not of course because they deserve it, but because the Court can find no alternative which will enable the government to collect its taxes. Is such a consummation worth the price that has to be paid? We cannot believe that this Court, mindful of the consequences, will put its stamp of approval on such a result.

II.

This Court has misinterpreted the rule of law set forth in controlling New York cases.

Appellant does not challenge the principle of law set forth in such cases as *Fox Film Corp.* v. *Loughman*, 259 N. Y. 30, *Calder* v. *Graves*, 261 App. Div. 90, *Groh* v. *Groh's Sons*, 80 App. Div. 85. It maintains, however, that this Court has misapprehended the principle of law established by those cases, and has failed, therefore, to recognize that the Trial Court's determination that the sum in question constituted dividends and not loans cannot be supported.

The cases above cited establish that dividends may be informally declared by a corporation by agreement among *all* of the stockholders. This rule is succinctly stated by the Court in *Groh* v. *Groh's Sons* as follows:

> "As between the owners and holders of *all* the stock of a corporation, it must, in principle, follow that the members of such corporation, entitled to receive dividends, may agree among themselves, either by conversation or otherwise, to appropriate of the funds of the corporation a specified sum, as agreed

> upon, and distribute the sum, and the stockholder upon the receipt of it, will acquire good title thereto as against the other members of the corporation." at 91 (Emphasis supplied.)

This Court, however, has misinterpreted this rule for it is stated that the line of cases in question

> "sustain the principle of law that if the sums in question were withdrawn with the acquiescence of all the shareholders and without any insistence that they be repaid, they must be regarded in New York law as dividends and not loans."

The error of the Court lies in its failure to distinguish between: (1) acquiescence of all the shareholders in the withdrawals; and (2) agreement on their part that the sums withdrawn need not be repaid.

While the Court might deem that the inaction of the non-withdrawing stockholders was tantamount to "acquiescence in the withdrawals", such inaction cannot justify the inference that they agreed that the sums withdrawn were not to be repaid. Indeed, the contrary is conclusively established by the Company's books and records, the acknowledgments of the withdrawing stockholders, and the pledge agreement pursuant to which the Company foreclosed its liens.

III.

The Court overlooked that absent fraud the recognition by the parties of the indebtedness precluded plaintiff's recovery.

A

The Court has failed to recognize the difference between the cases which were before it some years ago and the present one. To hold that the monies withdrawn by the

individuals should be subjected to taxation in their hands, the Court could and did ignore book entries and the like. In these actions, however, in which the government stands in the shoes of the individuals the Court cannot, with propriety, refuse to honor the legal relations established and recognized by the parties themselves.

B

The Court in affirming the decision below has overlooked the fact that the consistent acknowledgments by the withdrawing shareholders of their indebtedness, the admissions of the estates of Isaac and Bellette in these very actions of that indebtedness, and the forefeiture by those estates of interests having a value of not less than $260,000. and $160,000. respectively, are binding and conclusive upon them. In human experience, people do not relinquish interests so valuable except under compulsion. Since the withdrawing shareholders are bound, so too is the Government, for its rights to the debtor's property, absent fraud (and it has expressly disavowed any such claim), are no greater than those of the debtor. *U. S.* v. *Winnet*, 165 F. 2d 149 (9th Cir. 1947).

C

The Court erred not only in failing to give due weight to the admissions by the estates of Isaac and Bellette and the foreclosures and sale of their stock pursuant to a pledge agreement made more than eight years prior to the assertion of any tax liability, but also in failing to treat the payment of Jerome's indebtedness by his estate as conclusive. One does not pay sums of such magnitude to extinguish debts one does not owe. Proof of payment is proof of the existence of the debt. Of course, if there was some ulterior motive or nefarious purpose involved in the payment, it might be disregarded. There was no such motive or purpose, and consequently there could be no evidence of any.

Conclusion

We urge this Court in its desire to assist the Government in its efforts to collect its tax judgments not to disregard the rights of others, particularly where they have their foundation in fundamental principles of law and procedure.

Appellant respectfully submits that a rehearing should be granted and upon such rehearing the judgments appealed from should be reversed and the complaints dismissed.

CHARLES H. LIEB,
Member of the Firm.

PASKUS, GORDON & HYMAN,
Attorneys for Appellant,
19 Rector Street,
Borough of Manhattan,
New York City.

April 25, 1955.

Certificate of Counsel

CHARLES H. LIEB, a member of the firm of PASKUS, GORDON & HYMAN, attorneys for Appellant, does hereby certify that the annexed Petition for a rehearing is presented in good faith and not for the purpose of delay.

CHARLES H. LIEB

BRIEF FOR THE UNITED STATES

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	6
Conclusion	10

CITATIONS

Cases:

Burnet v. *Harmel*, 287 U. S. 103	9
Chattanooga Sav. Bank v. *Brewer*, 17 F. 2d 79, certiorari denied, 274 U. S. 751	7
Commissioner v. *Tower*, 327 U.S. 280	9
Corliss v. *Bowers*, 281 U. S. 376	9
Fitch v. *Helvering*, 70 F. 2d 583	7
Helvering v. *Clifford*, 309 U. S. 331	9
Helvering v. *Horst*, 311 U. S. 112	9
Hobbs v. *McLean*, 117 U. S. 567	8
Kommel v. *Herb-Gner Construction Co.*, 256 N.Y. 333, 176 N.E. 413	6
Lorillard v. *Clyde*, 86 N.Y. 384	9
Lucas v. *Earl*, 281 U. S. 111	9
Noel v. *Parrott*, 15 F. 2d 669, certiorari denied, 273 U. S. 754	8
Paramount-Richards Th. v. *Commissioner*, 153 F. 2d 602	7
Phillips v. *Commissioner*, 283 U. S. 589	9
Regensburg v. *Commissioner*, decided April 20, 1943, affirmed, 144 F. 2d 41, certiorari denied, 323 U.S. 783	5, 7
United States v. *Acri*, 348 U. S. 211	6
United States v. *Gilbert Associates*, 345 U. S. 361	6
United States v. *New Britain*, 347 U. S. 81	6
United States v. *Security Tr. & Sav. Bk.*, 340 U. S. 47	6

Statutes:

	Page
Internal Revenue Code of 1939:	
Sec. 3670 (26 U.S.C. 1952 ed., Sec. 3670)	2
Sec. 3672 (26 U.S.C. 1952 ed., Sec. 3672)	2
New York Stock Corporation Law, Sec. 59	8

Miscellaneous:

4 White on New York Corporations (12th ed.), Sec. 58, par. 43	8

In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 285

E. REGENSBURG & SONS, A CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 41-50) is reported at 124 F. Supp. 687. The opinion of the Court of Appeals (Pet. 14-16) is reported at 221 F. 2d 336.

JURISDICTION

The judgment of the Court of Appeals in each of these cases was entered on April 11, 1955 (R. 178-180). A petition for rehearing was denied on May 4, 1955 (R. 188). The petition for a writ of certiorari was filed on August 2, 1955. The juris-

diction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

Whether the courts below correctly held that sums withdrawn from a family corporation by stockholders thereof with the acquiescence of all the stockholders were dividends to them, and not loans, so that there was no debtor-creditor relationship between the stockholders and the corporation on account of the sums withdrawn.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 1952 ed., Sec. 3670.)

SEC. 3672 [as amended by Sec. 401, Revenue Act of 1939, c. 247, 53 Stat. 862.] VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*— Such lien shall not be valid as against any

mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

* * * * *

(26 U. S. C. 1952 ed., Sec. 3672.)

STATEMENT

These actions were brought by the United States to enforce its lien for unpaid income and estate taxes against certain stock which had allegedly been pledged to the issuing corporation, E. Regensburg & Sons, the petitioner herein, as security for loans from the corporation to the taxpayers-stockholders (R. 3-9, 22-28). The suits were consolidated for purposes of trial (R. 41). The facts were largely stipulated (R. 51-54, 80-109). The District Court's findings of fact are incorporated in its opinion (R. 41-50); on the basis of those findings the District Court concluded that the United States was entitled to judgment (R. 50). Judgments were entered accordingly (R. 20-21, and 39-40) and the corporation appealed. The cases were consolidated for purposes of appeal (R. 171) and the Court of Appeals affirmed (Pet. 16). The corporation filed a petition for rehearing which was denied (R. 188).

The findings of the District Court, supplemented by the evidence, may be summarized as follows:

E. Regensburg & Sons (herein sometimes referred to as the "corporation") is a New York corporation engaged in the manufacture of cigars (R. 11, 41). It was organized in 1903 as the suc-

cessor to a family partnership of the same name (R. 11-12, 41, 48).

The corporation's entire capital stock of 1,000 shares has always been held by members of the Regensburg family and its affairs have been under the control and management of that family (R. 41).

It was the practice of the corporation to permit stockholders to withdraw funds at will but the corporation's capital was at no time impaired and it at all times retained a substantial surplus (R. 48, 111-112).

Withdrawals were in excess of salaries and other credits to the stockholders, but no note was ever executed to evidence any indebtedness on the part of the stockholders to the corporation; there was no date fixed for any repayment and no interest was ever paid or accrued (R. 17, 19, 48).

The New York Trust Company, which from time to time advanced credit to the corporation, did not accord to these accounts the standing of assets in considering the credit standing of the corporation (R. 66).

In 1934, the stockholders and the corporation executed an agreement which contained provisions restricting disposition of the stock and also a provision whereby each stockholder granted to the corporation a lien on his stock to the extent of existing or future indebtedness owing from such stockholder to the corporation. The stock certificates were stamped with a legend accordingly and retained in the possession of the corporation (R. 43, 84, 93-98).

As withdrawals continued, the book value of the stock was not sufficient to cover the amount of the withdrawals. Isaac and Bellette, the two deceased stockholders whose taxes are here involved, had virtually no income-producing property except their stock. No effort was made by the corporation to enforce payment from any stockholder during his lifetime (R. 48, 55-56, 85-86).

In 1942, the Commissioner of Internal Revenue determined that sums withdrawn from the corporation by the stockholders during the years 1936 to 1940, inclusive, constituted taxable dividends. The matter went to the Tax Court which upheld the Commissioner (*Regensburg* v. *Commissioner,* decided April 20, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,185)). The Court of Appeals for the Second Circuit affirmed, 144 F. 2d 41, and this Court denied certiorari, 323 U. S. 783. The tax liabilities assessed against Isaac and Bellette or their estates as a result of the foregoing decision constitute the greater part of the tax liabilities which the United States seeks to collect in the instant suits. Notices of lien for such taxes were duly filed by the Government on January 17, 1945 (R. 42, 43, 88).

In 1947 and 1948, respectively, the corporation foreclosed its alleged liens on the 268⅜ shares of its stock owned by the estate of Isaac and the 118⅜ shares owned by the estate of Bellette. The corporation bid in the stock of Isaac for $275,000 and the stock of Bellette for $110,000; but this was far

from enough to satisfy their alleged indebtedness to the corporation (R. 48, 86.)

In 1949, the United States commenced these actions to set aside such foreclosures and to enforce its lien against the stock. Both courts below held that the United States was entitled to judgment.

ARGUMENT

The decisions of the two lower courts turn on a question of fact and are correct. No question of general importance is presented.

1. Both courts below correctly held on the evidence that the withdrawals by Isaac and Bellette Regensburg, the estates of whom are taxpayers herein, were dividends and not loans. It follows that no valid pledge was ever created under the 1934 agreement, since there was no debtor-creditor relationship between the Regensburgs and the corporation such as is required to support a valid pledge. *Kommel* v. *Herb-Gner Construction Co.*, 256 N. Y. 333, 176 N. E. 413. Accordingly, the corporation had no valid lien on the shares alleged to have been pledged; there could be no valid foreclosure by petitioner corporation against the shares; and, as held by the courts below, the Government's lien must prevail. *United States* v. *New Britain*, 347 U. S. 81; *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47; *United States* v. *Gilbert Associates*, 345 U. S. 361; *United States* v. *Acri*, 348 U. S. 211.

The question whether the withdrawals were dividends or loans for federal tax purposes turns on whether the withdrawals were intended as a per-

manent distribution. If a withdrawal is intended as a permanent distribution, it is a dividend notwithstanding that the formalities of a dividend declaration have not been observed, that the withdrawal is recorded on the corporate books as a loan, that it is not in proportion to stockholdings, or even that some of the stockholders do not participate in it. *Fitch* v. *Helvering,* 70 F. 2d 583 (C. A. 8th); *Chattanooga Sav. Bank* v. *Brewer,* 17 F. 2d 79 (C. A. 6th), certiorari denied, 274 U. S. 751; *Paramount-Richards Th.* v. *Commissioner,* 153 F. 2d 602 (C. A. 5th). As we have noted, this same question, in a suit to determine the income tax liability of the Regensburg brothers on account of the withdrawals, was considered by the court below in *Regensburg* v. *Commissioner,* 144 F. 2d 41, certiorari denied, 323 U. S. 783. There the court below, recognizing the factual character of the issue, sustained the determination of the Tax Court that the withdrawals in question were dividends and not loans. Similarly in this case the trial court held that (R. 47): "The preponderance of the evidence viewed in its entirety reveals no intention on the part of the company to treat the withdrawals as binding obligations,"[1] and accordingly concluded that the withdrawals must be regarded as dividends. In affirming this judgment, the court below pointed out (Pet. 16) "that no note was ever exe-

[1] As the District Court aptly said (R. 48): "Since the Regensburg family at all times dominated the firm, in ownership and control, it would appear that Isaac and Bellette Regensburg, as well as the other family stockholders, continued to regard the company as the partnership it once was."

cuted to evidence any indebtedness on the part of the shareholders, and no interest was ever paid or accrued on the balances shown in their accounts."

2. Petitioner contends that the decision below is in conflict with the applicable New York law. But as the court below held, the result is the same under New York law (Pet. 16):

> Such cases as *People ex rel. Fox Film Corp.* v. *Loughman,* 259 N. Y. 30; *Matter of Calder* v. *Graves,* 261 App. Div. 90, aff'd 286 N. Y. 643; and *Groh's Sons* v. *Groh,* 80 App. Div. 85, all sustain the principle of law that if the sums in question were withdrawn with the acquiescence of all the stockholders and without any insistence that they be repaid, they must be regarded, in New York law, as dividends, and not as loans. Nor is the appellant helped by *Ellner Co.* v. *Isaacson,* 165 N. Y. Supp. 942, or *Famous Realty, Inc.* v. *Frindel,* 135 N. Y. Supp. 2d 261.

And see 4 White on New York Corporations (12th ed.), Section 58, par. 43.

It should also be noted that if the withdrawals had been loans they would have been illegal under New York law because Section 59 of the New York Stock Corporation Law prohibits loans by a corporation to its stockholders. And it is settled that where a transaction is fairly open to two constructions, by one of which it would be lawful and by the other unlawful, the former should be adopted. *Hobbs* v. *McLean,* 117 U. S. 567, 576; *Noel* v. *Par-*

rott, 15 F. 2d 669 (C. A. 4th), certiorari denied, 273 U. S. 754; *Lorillard* v. *Clyde,* 86 N. Y. 384.

3. We do not here contend, as suggested by petitioner (Pet. 8-9), that all income taxable to a person must necessarily be treated as his for collection purposes. Cf. *Helvering* v. *Clifford,* 309 U. S. 331; *Lucas* v. *Earl,* 281 U. S. 111; *Helvering* v. *Horst,* 311 U. S. 112. In some instances, collectibility may depend upon considerations with respect to transferee liability (*Phillips* v. *Commissioner,* 283 U. S. 589); but no such question is presented here.

Moreover, we do not disagree with the general proposition (see Pet. 8) that the legal significance of facts under state law may differ from their significance for federal tax purposes. *Commissioner* v. *Tower,* 327 U. S. 280, 287-288; *Corliss* v. *Bowers,* 281 U. S. 376, 378; *Burnet* v. *Harmel,* 287 U. S. 103, 110. That proposition is without application here, however, since the court below correctly held that the withdrawals constituted dividends under both the New York law and the federal tax law.

CONCLUSION

The decision below is correct and there is no conflict of decisions or any question of general importance requiring review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
L. W. POST,
Attorneys.

SEPTEMBER, 1955.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1955 986393 212

SEP 30 1955

HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

No. 285

UNITED STATES OF AMERICA,
Respondent,

v.

E. REGENSBURG & SONS, a corporation,
Petitioner,

and

ADELE REGENSBURG, Executrix of the Estate of ISAAC REGENSBURG, deceased,
Defendant.

UNITED STATES OF AMERICA,
Respondent,

v.

E. REGENSBURG & SONS, a corporation,
Petitioner,

and

SALLY REGENSBURG PERLS ROSS and EDWARD BELLETTE REGENSBURG, as Administrators c. t. a. of the Estate of Bellette Regensburg, deceased,
Defendants.

PETITIONER'S REPLY BRIEF

ARTHUR B. HYMAN,
Attorney for Petitioner,
19 Rector Street,
New York, New York.

PETITIONER'S REPLY BRIEF

It is deplorable that in an effort to prevent review by this Court of an important question of law affecting the collection of revenue, the Government should attempt to persuade this Court that the decisions below turned upon questions of fact.

The Government admits that "the facts were largely stipulated", and, indeed, it is upon the stipulated facts that the sole question of law sought to be reviewed evolves. Review is sought by petitioner solely upon the ground that the decision below implants in our jurisprudence the revolutionary doctrine that the Government, suing as a judgment creditor, has rights superior to those possessed by other judgment creditors in similar actions. Such special divinity does not exist and the decisions below are legally unsupportable.

No less deplorable is the statement in the Government's brief that the withdrawals were made with the acquiescence of all of the stockholders. That statement is untrue and there is nothing in the record which supports it. On the contrary, in 1934, the basic date involved, the non-indebted stockholders acquired protection by the execution of an agreement pursuant to which the stock of the indebted stockholders was pledged with the company to secure the repayment of their indebtedness. Moreover, and equally important, it was incumbent upon the Government to establish more than merely that all the stockholders acquiesced in the loans. It was required to, but did not and could not, show that the non-indebted stockholders agreed that the indebted stockholders need not repay their loans.

The Government wins its point only when justice is done. The victories achieved below, at a sacrifice of legal

principles and without concern for the impoverishment of the non-indebted stockholders, are Pyrrhic. They should not stand without scrutiny by this Court.

Respectfully submitted,

ARTHUR B. HYMAN,
Counsel for Petitioner.

September 29, 1955.